City of Culver City, California

City Council Agenda Item Report

Meeting Date: 05/05/08		Item Number: J-1
AGENDA ITEM: JOINT ITEM: Presentation of Draft Actuarial Valuation Study of Post-Retirement Health Benefits		
Contact Person/Dept.: Jeff Muir, CFO	Phone Number: 310.253.6016	
Fiscal Impact: Yes [X] No []	General Fund: Yes [X] No []	
Public Hearing: []	Action Item: [X]	Attachments: [x]
Public Notification: Master Notification List (4/30/08)		
Department Approval: Jeff Muir (04/30/08)	City Attorney Approval: Carol Schwab (by H. Baker) (04/30/08)	
Fiscal Impact Review: Jeff Muir (04/30/08)	City Manager Approval: Jerry B. Fulwood (04/30/08)	

RECOMMENDATION:

Staff recommends the City Council receive an overview presentation of the draft actuarial valuation study of Post-Retirement Health Benefits by AON Consulting and the Chief Financial Officer.

BACKGROUND:

The Governmental Accounting Standards Board (GASB) is the organization that is responsible for providing the standards that apply to financial reports of all state and local governmental entities. In June of 2004, GASB issued Statement No. 45: Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions (GASB 45).

In addition to pensions, many state and local governmental employers provide Other Post-Employment Benefits (OPEB) as part of the total compensation offered to attract and retain the services of qualified employees. OPEB includes post-employment healthcare, as well as other forms of post-employment benefits (for example, life insurance) when provided separately from a pension plan. GASB 45 established standards for the measurement, recognition, and display of OPEB expense/expenditures and related liabilities (assets), note disclosures, and, if applicable, required supplementary information (RSI) in the financial reports of state and local governmental employers. Culver City offers post-employment health care benefits to qualifying retirees. Culver City is required to implement GASB 45 into its financial statements effective with Fiscal Year 2008-09.

The approach followed in GASB 45 generally is consistent with the approach adopted in GASB Statement No. 27, Accounting for Pensions by State and Local Governmental Employers (GASB 27), with modifications to reflect differences between pension benefits and OPEB. Statement No. 43, Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans (GASB 43), addresses financial statement and disclosure requirements for reporting by administrators or trustees of OPEB plan assets or by employers or sponsors that include OPEB plan assets as trust or agency funds in their financial reports.

The Approach of GASB 45

Post-Employment benefits (OPEB as well as pensions) are part of an exchange of salaries and benefits for employee services rendered. Of the total benefits offered by employers to attract and retain qualified employees, some benefits, including salaries and active-employee healthcare, are taken while the employees are in active service, whereas other benefits, including post-employment healthcare and other OPEB, are taken after the employees' services have ended. Nevertheless, both types of benefits constitute compensation for employee services.

From an accrual accounting perspective, the cost of OPEB, like the cost of pension benefits, generally should be associated with the periods in which the exchange occurs, rather than with the periods (often many years later) when benefits are paid or provided. However, in current practice, most OPEB plans are financed on a pay-as-you-go basis, and financial statements generally do not report the financial effects of OPEB until the promised benefits are paid. As a result, current financial reporting generally fails to:

- Recognize the cost of benefits in periods when the related services are received by the employer
- Provide information about the actuarial accrued liabilities for promised benefits associated with past services and whether and to what extent those benefits have been funded
- Provide information useful in assessing potential demands on the employer's future cash flows.

GASB 45 changes the financial reports issued by governmental entities by (a) requiring systematic, accrual-basis measurement and recognition of OPEB cost (expense) over a period that approximates employees' years of service and (b) providing information about actuarial accrued liabilities associated with OPEB and whether and to what extent progress is being made in funding the plan.

Measurement (the Parameters)

Employers that participate in single-employer or agent multiple-employer defined benefit OPEB plans (sole and agent employers) are required to measure and disclose an amount for annual OPEB cost on the accrual basis of accounting. Annual OPEB cost is equal to the employer's annual required contribution to the plan (ARC), with certain adjustments if the employer has a net OPEB obligation for past under- or over-contributions.

The ARC is defined as the employer's required contributions for the year, calculated in accordance with certain parameters, and includes (a) the normal cost for the year and (b) a component for amortization of the total unfunded actuarial accrued liabilities (or funding excess) of the plan over a period not to exceed thirty years. The parameters include requirements for the frequency and timing of actuarial valuations as well as for the actuarial methods and assumptions that are acceptable for financial reporting. If the methods and assumptions used in determining a plan's funding requirements meet the parameters, the same methods and assumptions are required for financial reporting by both a plan and its participating employer(s). However, if a plan's method of financing does not meet the parameters (for example, the plan is financed on a pay-as-you-go basis), the parameters nevertheless apply for financial reporting purposes.

Under GASB 45, for financial reporting purposes, an actuarial valuation is required at least biennially for OPEB plans with a total membership (including employees in active service, terminated employees who have accumulated benefits but are not yet receiving them, and retired employees and beneficiaries currently receiving benefits) of 200 or more, or at least triennially for plans with a total membership of fewer than 200. Culver City has a total membership exceeding 200, and will therefore be required to have biennial actuarial valuations.

The projection of benefits included in the actuarial valuation should include all benefits covered by the current substantive plan (the plan as understood by the employer and plan members) at the time of each valuation and should take into consideration the pattern of sharing of benefit costs between the employer and plan members to that point, as well as certain legal or contractual caps on benefits to be provided. The parameters require that the selection of actuarial assumptions, including the healthcare cost trend rate for post-employment healthcare plans, be guided by applicable actuarial standards.

Net OPEB Obligation—Measurement

An employer's net OPEB obligation is defined as the cumulative difference between annual OPEB cost and the employer's contributions to a plan, including the OPEB liability or asset at transition, if any. (Because retroactive application of the measurement requirements of GABS 45 is not required, for most employers, including Culver City, the OPEB liability at the beginning of the transition year will be zero.) An employer with a net OPEB obligation is required to measure annual OPEB cost equal to (a) the ARC, (b) one year's interest on the net OPEB obligation, and (c) an adjustment to the ARC to offset the effect of actuarial amortization of past under- or over-contributions.

Financial Statement Recognition and Disclosure

Sole and agent employers should recognize OPEB expense in an amount equal to annual OPEB cost in government-wide financial statements and in the financial statements of proprietary funds and fiduciary funds from which OPEB contributions are made. OPEB expenditures should be recognized on a modified accrual basis in governmental fund financial statements. Net OPEB obligations, if any, including amounts associated with under- or over-contributions from governmental funds, should be displayed as liabilities (or assets) in government-wide financial statements. Similarly, net OPEB obligations associated with proprietary or fiduciary funds from which contributions are made should be displayed as liabilities (or assets) in the financial statements of those funds.

Employers are required to disclose descriptive information about each defined benefit OPEB plan in which they participate, including the funding policy followed. In addition, sole and agent employers are required to disclose information about contributions made in comparison to annual OPEB cost, changes in the net OPEB obligation, the funded status of each plan as of the most recent actuarial valuation date, and the nature of the actuarial valuation process and significant methods and assumptions used. Sole and agent employers also are required to present as RSI a schedule of funding progress for the most recent valuation and the two preceding valuations, accompanied by notes regarding factors that significantly affect the identification of trends in the amounts reported.

Effective Dates and Transition

GASB 45 generally provides for prospective implementation—that is, that employers set the beginning net OPEB obligation at zero as of the beginning of the initial year. Implementation is required in three phases based on a government's total annual revenues in the first fiscal year ending after June 15, 1999. The definitions and cutoff points for that purpose are the same as those in GASB 34, Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments. GASB 34 is effective for periods beginning after December 15, 2006, for phase 1 governments (those with total annual revenues of $100 million or more); after December 15, 2007, for phase 2 governments (those with total annual revenues of $10 million or more but less than $100 million); and after December 15, 2008, for phase 3 governments (those with total annual revenues of less than $10 million). Culver City is considered a phase 2 city and will be required to implement GASB 45 into its financial statements beginning with Fiscal Year 2008-09 and all years thereafter.

DISCUSSION:

On November 14, 2007, the City Council awarded a contract to AON Consulting to perform an actuarial study associated with the implementation of GASB 45. The primary purpose of this study was to determine the long-term costs of the City's medical insurance for retirees. The draft report (Draft Report) was recently provided to the City and presented to the Budget & Finance Subcommittee. The report analyzes the cost to provide the benefits currently offered over the next thirty years, based on current active and retired employees, and using actuarial assumptions and trends.

The City currently funds this benefit on a pay-as-you-go basis, and the estimated amount for Fiscal Year 2007-08 is $3.7 million. The Draft Report shows that this cost will continuously rise at a fairly significant rate, doubling from the current amount by 2017 and reaching almost $14 million per year at the end of the thirty years. If the City wanted to pre-fund this benefit today, it would need to invest $105 million with a 7.75% rate-of-return (similar to what CalPERS assumes for their portfolio), or $208 million if it earned 4% (the approximate earnings rate for the City's investment portfolio). If the City chose to fund the benefit pursuant to GASB 45 over the thirty years, and deposit funds annually into an irrevocable trust fund, it would require $7.4 million annually in a trust earning 7.75% (lower earnings would require a higher amount). This means basically doubling the current amount the City pays. While there is not a legal requirement to fund this amount, the issue facing the City is that in about ten years this is the amount the City will need to fund on a pay-as-you-go basis, and it will continue to rise. Additionally, the City will be required to report the difference between the Actuarially Required Contribution (ARC) and what it actually funds on its financial statements.

There are only two achievable methods to control the future costs of retiree medical coverage: Pre-funding these future costs or limiting liability. There are several ways the future liabilities can be limited, including: curbing (reducing) benefits, capping employer contributions, converting to a defined contribution plan or increasing vesting requirements. For reference, the average present value of the current retiree medical benefit is nearly $200,000 per employee. The City has formed a Health Benefits Committee consisting of staff from the Departments of Human Resources and Finance and from the City Manager's Office, along with representatives from the City's bargaining groups to discuss this issue. The Proposed 2008-09 and 2009-10 Budget allocates $100,000 towards pre-funding this benefit. Further pre-funding of the existing benefits will require identifying significant new revenues or expenditure reductions in other areas.

An actuary from AON Consulting will be providing a summary explanation and discussion of the draft report.

ATTACHMENTS:

1. Draft Actuarial Valuation Report

MOTION:

That the City Council and Redevelopment Agency:

Receive a presentation from AON Consulting and the Chief Financial Officer.